marginal value of carriage of the other network. There is absolutely no need for the two networks to be perfect substitutes in order for combined ownership to have a significant effect on programming fees.

3. DIFFERENT TYPES OF PROGRAMMING

Drs. Israel and Katz observe that local broadcast stations carry programming that, in at least some respects, is clearly quite different than the programming carried by RSNs.[34] They also note that the Commission itself has observed exactly the same thing.[35] They assert that the fact that these two different types of networks carry different types of programming should be viewed as evidence that these two types of networks are not partial substitutes for one another.

While I agree that local broadcast stations and RSNs carry different types of programming, I completely reject the assertion that this somehow implies that these two types of networks cannot be partial substitutes for one another. To the extent that substitutability between networks is caused simply by the fact that subscribers value increases in variety at a decreasing rate, it is perfectly possible and reasonable that two very different types of networks could be partial substitutes for one another in the sense that the value of adding one of the two networks decreases conditional on the other network already being carried.

Consider the numerical example I described in the previous section where the marginal value of carrying the first network is $1.00 and the marginal value of carrying the second network is $.50. It is perfectly reasonable to interpret this example as corresponding to the case where the two networks carry different types of programming. Suppose, for example that one of the

[34] *See Israel Katz Report II* at para. 111.

[35] *See Israel Katz Report II* at para. 104.

networks is a movie network and one is a sports network. Suppose all subscribers are identical and like to watch some sports and some movies. It is perfectly reasonable and plausible to hypothesize that subscribers would be willing to pay an extra dollar to add either a movie or sports channel but, once one of the two had been added and they had more variety to choose from, that they would only be willing to pay an additional $.50 to add the second network.

4. PERFECT SUBSTITUTES

In addition to noting that the Commission has observed that local broadcast stations carry different types of programming than RSNs, Drs. Israel and Katz also quote the Commission as having noted that the "unique nature" of regional sports programming means that there are "no adequate substitutes" for this type of programming.[36] As I understand the argument of Drs. Israel and Katz, they would like us to conclude that the Commission's statement that there are "no adequate substitutes" for RSNs should be interpreted as meaning that the Commission is stating that local broadcast stations and RSNs cannot be partial substitutes for one another in the sense necessary for combined ownership to result in increased program fees. I completely disagree with this interpretation. The straightforward interpretation of the Commission's statement is that it is observing that there are no perfect substitutes or even near-perfect substitutes for RSNs. I have already explained why my theory of harm does NOT require networks to be perfect substitutes in order for combined ownership to result in increased program fees. It is sufficient that the networks be partial substitutes in order for my theory to apply.

5. DEMOGRAPHIC DIFFERENCES IN VIEWERS

[36] *See Israel Katz Report II* at para. 104 citing the *DirecTV-News Corp. Order* at para. 59-60.

Drs. Israel and Katz report that there are some demographic differences between viewers of local broadcast stations and viewers. In particular they note that RSNs tend to attract an audience that is somewhat more male and younger than the audience for local broadcast stations. They assert that these differences imply that the two types of networks cannot be partial substitutes for one another. Once again, it is not clear why the fact that two networks have somewhat different demographic profiles would necessarily imply that they cannot be partial substitutes for one another. First, even if the demographics of the networks are not identical, it may well still be the case that a large majority of individuals watch both types of networks. So long as most individuals watch both types of networks, it would be possible for most individuals to view the networks as partial substitutes. Furthermore, many households consist of multiple individuals with different demographic characteristics. Therefore even if not all individuals in a household watch both types of networks, it may well be that a much larger percentage of households watch both types of networks. Therefore households may view two networks as being partial substitutes even if individuals within the household do not. Of course, it is the entire household that must make the decision of what MVPD to subscribe to.

5. CONCENTRATION RATIOS

Drs. Israel and Katz define the concentration ratio for a programmer to be the share of total viewing hours that households devote to all networks produced by the programmer. They calculate concentration ratios for NBCU and Comcast prior to the transaction and the concentration ratio for the joint venture after the transaction and note that all of these concentration ratios are relatively low compared to the levels of concentration ratios that antitrust authorities would traditionally view as creating market power. As I understand their argument, they suggest that this provides evidence that neither NBCU, Comcast, nor the joint venture have market power over any programming and that no horizontal theory of harm could therefore be true. This completely ignores the Commission's own determination that calculating concentration ratios in this manner is not the correct way to assess the extent of market power in programming markets. In particular, Commission has repeatedly concluded that RSNs and local broadcast networks both create significant amounts of market power.[37]

6. EMPIRICAL ANALYSIS

In my initial report I described some empirical evidence that suggests that joint ownership or control of multiple Big 4 local broadcast stations in the same DMA results in higher retransmission consent fees. While this does not provide any direct evidence on the issue of whether combined ownership of an RSN and local broadcast station will result in increased programming fees, it does provide evidence on the somewhat more general point that combined control of multiple must have networks can result in higher programming fees. However, I certainly agree that the most direct evidence on my theory of horizontal harm as it applies to the combination of NBC O&Os and Comcast RSNs would be evidence on whether combined ownership of an RSN and local broadcast station results in increased programming fees, holding

[37] For example, in its evaluation of the DirecTV-News Corp. transaction, the Commission concluded that "News Corp. currently possesses significant market power in the DMAs in which it has the ability to negotiate retransmission consent agreements on behalf of local broadcast stations" and justified this conclusion in part by observing that "carriage of local television broadcast stations is critical to MVPD offerings." (*See DirecTV-News Corp. Order* at para. 201-202). It similarly concluded that "News Corp. currently possesses significant market power with respect to its RSNs within each of their specific geographic regions" (*See Adelphia-Time Warner-Comcast Order* at para. 147) based on similar observations.

all other factors constant. In my initial report I stated that no such evidence was available and that the evidence I presented on the effect of combined ownership or control of multiple Big 4 local broadcast stations in the same DMA was therefore the best available evidence.

There is, of course, some data that is potentially available on the issue of how combined ownership of an RSN and local broadcaster in the same region affects programming fees. This is because News Corp. owns a large number of Fox local broadcast stations and RSNs and has purchased and sold various Fox local broadcast stations and RSNs over the last decade. Consider any particular RSN. If News Corp. owns the RSN and also owns a Fox local broadcast station that operates in at least part of the region served by the RSN, I will say that the RSN is under "combined ownership." If Fox does not own the RSN or if Fox does own the RSN but does not own a Fox local broadcast station that overlaps with the RSN, I will say that the RSN is not under combined ownership. When News Corp. purchases or sells an RSN, it is possible that the transaction will affect the combined ownership status of the RSN. Similarly if News Corp. purchases or sells a Fox local broadcast station, it is possible that the transaction will affect the combined ownership status of RSNs owned by News Corp. that operate in the DMA served by the Fox local broadcast station. Therefore, if one were able to identify transactions that changed the combined ownership status of particular RSNs and gather fee data for each RSN for a period both before and after the transaction, it would in principle be possible to attempt to determine how the transaction affected programming fees. Drs. Israel and Katz conduct a study of this sort.

To the best of my knowledge, at the time that I wrote my initial report, no one had attempted to conduct such an exercise, and for good reason. Because of limitations in the amount and type of data available and the inherent impossibility of controlling for other factors that might affect RSN fees, it would be impossible or at least very difficult to draw any meaningful or useful conclusions from such a study. The two main, related problems are that: (1) there is only a handful of such events; and, (2) RSN fees can be dramatically affected by a variety of events that are difficult to control for. In particular, changes in which sports teams are carried by a particular RSN can dramatically change the attractiveness of an RSN to subscribers overnight. A compounding factor in this particular type of study is that many of the events involve a change in ownership of the RSN itself. When the ownership of an RSN changes, it is reasonable to expect that there may be large changes in the fees charged by the RSN, simply because the new management has a different type of strategy or management style or because changes in ownership are associated with changes in the teams carried by the RSN or changes in other important factors that might affect fees. Thus, a change in ownership of an RSN is inherently an event that we would expect to have potentially large and unpredictable effects on the RSN's pricing quite independent of any issue associated with combined ownership. If there were a very large number of such events, perhaps we could hope that these difficult-to-control-for variables would average out. However, when there is only a handful of such events to begin with, and there are inherently so many other factors that could affect RSN fees that are likely to be changing at the same time, an empirical analysis that simply ignores all of these issues would not be able to provide any useful information about the effect of combined ownership on RSN fees.

To be more specific about the flaws with the empirical analysis undertaken by Drs. Israel and Katz, it will be necessary for me to describe the data they consider in somewhat more detail. Drs. Israel and Katz have annual fee data on all RSNs for the period 1999-2009. Define a "transaction" to be an RSN/year pair where the combined ownership status of the RSN changed in the given year. As I understand their procedure, Drs. Israel and Katz made the judgment that having one year of data on each side of the transaction was sufficient to allow them to investigate for the presence or absence of pricing effects. Therefore, as I understand their procedure, Drs. Israel and Katz considered all transactions in the years 2000-2008.[38] Based on my interpretation of Table V.5 in *Israel Katz Report II*, it appears that Drs. Israel and Katz were able to identify eleven transactions to investigate. I list all of these transactions below in Table III.1 and describe the nature of each transaction.

[38]This guarantees that there will be at least one year of data before the event and at least one year of data after the event.

TABLE III.1
A LIST OF ALL TRANSACTIONS CONSIDERED BY DRS. ISRAEL AND KATZ IN THEIR EMPIRICAL ANALYSIS OF THE EFFECT OF COMBINED OWNERSHIP ON PROGRAM FEES

RSN*	DATE	DESCRIPTION OF THE TRANSACTION**
FSRM	2008	News Corp. sold a Fox station in the RSN's region
FSM	2008	News Corp. sold a Fox station in the RSN's region
FSU	2008	News Corp. sold a Fox O&O in the RSN's region
FSM	2008	News Corp. sold a Fox O&O in the RSN's region
FSW	2008	News Corp. sold a Fox O&O in the RSN's region
FSO	2008	News Corp. sold a Fox O&O in the RSN's region
SS	2006	News Corp. purchased the RSN; a Fox O&O
FSF	2005	News Corp. purchased the RSN and already owned a Fox station
FSO	2005	News Corp. purchased the RSN and already owned a Fox station
FSW	2001	News Corp. purchased the RSN and already owned a Fox station
FSN	2001	News Corp. purchased the RSN and already owned a Fox station

* The following abbreviations are used for RSNs.

FSRM	=	Fox Sports Rocky Mountain
FSM	=	Fox Sports Midwest
FSU	=	Fox Sports Utah
FSW	=	Fox Sports Wisconsin
FSN	=	Fox Sports North
FSO	=	Fox Sports Ohio
FSF	=	Fox Sports Florida
SS	=	Sports South

** "News Corp. sold a Fox station in the RSN's region" means "Before the transaction, News Corp. owned the RSN and a Fox local broadcast station serving the RSN's region. The transaction is that News Corp. sold the Fox station."

"News Corp. purchased the RSN and already owned a Fox station" means "Before the transaction, News Corp. did not own the RSN but did own a Fox station that operated in the RSN's region. The transaction is that News. Corp. purchased the RSN."

The first thing to notice about this list of transactions is that six of the eleven listed transactions all occurred in 2008 when News Corp. sold a number of Fox O&Os. Since Drs. Israel and Katz have annual fee data from 1999-2009, this means thet they only heve one post-transaction year of data for RSN fees for these six transactions. Furthermore, it is typically the case that programmers and MVPDs sign multi-year agreements. Therefore it may well be the case that many of the RSN fees paid in 2009 were determined by contracts signed prior to News Corp.'s sale of the Fox affiliates. Therefore, in my judgment, these six transactions should not be included in the study. This leaves Drs. Israel and Katz with only five transactions.

Examination of these five transactions shows that all of them involve News Corp. purchasing the RSN. As I stated above, the inherent problem with looking at RSN fee data around the time of an ownership change is thet we might expect there to be large changes in the RSN's fee structure at this point due to changes in ownership that are completely unrelated to any combined ownership effect. For example, just prior to News Corp. purchasing Turner South in 2006 from Turner Broadcasting, the network showed a variety of regionally-oriented programming and, in particular, did not restrict itself to showing only sports programming. However, after purchasing the network, News Corp. changed the network's name to SportSouth and changed its focus so that it exclusively showed regional sports programming.[39] This transformation in programming focus may well have resulted in significant changes in program fees quite unrelated to the combined ownership effect.

Finally, recall that another general problem I identified above is that RSN program fees can change dramatically and unpredictably due to changes in the sports teams that the network carries. If a team change occurs at the same time as an ownership change, it would be critical to control for

[39] *See* Mike Reynolds, "Network Reclaims Old Name," Multichannel News, October 7, 2008.

the team change. Drs. Israel and Katz make no attempt of any sort to control for changes in the teams that RSNs carry. In particular, note that one event that Drs. Israel and Katz include in their analysis is News Corp.'s acquisition of a controlling interest in Fox Sports Ohio in 2005. They attribute any subsequent changes in Fox Sports Ohio's fees to this change in ownership. However, during this same year Fox Sports Ohio experienced a major team loss, as reported in a declaration of the President of Massillon Cable TV that is another MVPD that operates in this area and carries Fox Sports Ohio.

> "In 2005, Massillon had an agreement with Fox Cable Networks, Inc. ("Fox") to carry Fox Sports Net Ohio ("FSNO"). The vast bulk of 'marquee' live sporting events carried on FSNO - more than two-thirds (2/3) of the professional sports content – was Cleveland Indians baseball games. On December 26, 2005, the Cleveland Indians announced that its was creating its own regional sports network, Sports Time Ohio, and moving all of its games from FSNO."[40]

This event may well have significantly reduced the level of program fees that Fox Sports Ohio was able to charge. Thus, even if the effect of combined ownership in 2005 was to raise programming fees, the loss of the Cleveland Indians may well have caused an even larger reduction in program fees. Thus it is certainly possible that the net effect on Fox Sports Ohio's fees from all of the events of 2005 was to reduce its program fees. Drs. Israel and Katz would interpret this as suggesting that combined ownership can reduce program fees. I think it would be more correct to interpret this an example of a uncontrolled-for events that invalidates their analysis.

Therefore, of the five remaining transactions that might in principle be reasonable events

[40] *Declaration of Robert Gessner*, Artached to *Reply Comments of the American Cable Association, In the Matter of Comcast Corporation, General Electric Company, and NBC Universal, Inc. To Assign and Transfer Control of FCC Licenses, MB Docket No. 10-56,* August 19, 2010 ("*Gessner Declaration*") at para. 4.

for Drs. Israel and Katz to study, my own very limited search for uncontrolled for events has revealed that for at least two of the transactions, there were uncontrolled for events that likely had a significant effect on pricing. My search for uncontrolled for events was not exhaustive or complete. It is very possible that uncontrolled for events also occurred along with the other three transactions. Therefore I would view even these three remaining transactions as being suspect. Therefore, at best Drs. Israel and Katz are left with three suspect transactions to analyze.

In summary then, although Drs. Israel and Katz have conducted an empirical study that attempts to measure the effect of combined ownership of an RSN and local broadcaster serving the same region on program fees, there are simply too many flaws with the study and the data for these results to provide any useful information on the issue they claim to be studying. Therefore, the evidence I report on the effect of combined ownership of multiple Big 4 broadcasters in the same DMA on retransmission consent prices is still the best available evidence on this issue. While not directly addressing the issue of whether combined ownership of an RSN and local broadcast station in the same region will raise programming fees, it provides evidence on the more general point that combined ownership of multiple must have networks can result in higher programming fees.

IV. REMEDIES

1. INTRODUCTION

With my advice, the ACA has constructed a set of conditions that I believe would substantially address both the vertical and horizontal harms of the transaction that I have identified, while still allowing the transaction to proceed. A statement of the proposed ACA conditions is included in an attachment to the ACA reply comments.[41] In this section I will begin by briefly reviewing two important points relevant to the issue of conditions that I discussed in my initial paper. Then, I will describe the ACA conditions and explain why they will address the vertical and horizontal harms created by this transaction, both for larger MVPDs and their customers and for smaller MVPDs and their customers.

1. PROGRAM ACCESS RULES

Program access rules are in a general sense intended to prevent vertically integrated programmers from discriminating against unaffiliated MVPDs. Although they do not apply to retransmission consent agreements and it is not clear whether they apply to on-line programming, it would certainly be possible to extend their application to these types of programming as a condition of approving the transaction. Therefore, two natural first questions to consider are: (i) whether it would make sense to extend the application of program access rules to these types of programming as a condition of the transaction; and, (ii) whether this simple condition would be sufficient to address the vertical harm created by the transaction.

In my initial report, I described two significant problems with program access rules over and above the fact that they do not apply to some types of programming. The first problem is the "quantity discounts loophole." This problem occurs because program access rules have been interpreted as allowing a vertically integrated MVPD significant freedom to charge competing MVPDs higher rates for programming than it charges itself, so long as the competing MVPDs

[41] *See* "ACA's Proposed Comcast-NBCU License Transfer Conditions," Attachment C in *ACA Reply Comments, In the Matter of Applications of Comcast Corporation, General Electric Company, and NBC Universal, Inc., to Assign and Transfer Control of FCC Licenses,* MB Docket No. 10-56, August 19, 2010("*ACA Reply Comments*")

have a smaller number of subscribers than the vertically integrated MVPD. Since Comcast is the nation's largest MVPD, this means that program access rules would be particularly ineffectual in limiting the extent to which Comcast-NBCU will be able to discriminate against its rivals. The second problem is the "arbitrary transfer prices" problem. This problem occurs because vertically integrated firms who wish to charge high discriminatory prices to rival MVPDs may be able to do so without violating program access rules simply by raising the internal transfer price they charge themselves to the same high level and then instructing their downstream divisions to continue to purchase the integrated programming at artificially high internal transfer prices.

I believe that even given these problems, program access rules may have some impact on limiting the extent to which vertically integrated firms can discriminate against rival MVPDs. Furthermore, the non-exclusivity provisions of program access rules play the desirable role of preventing vertically integrated firms from simply announcing that they will not sell their programming to rival MVPDs at any price. Therefore, I believe that it would be desirable for the Commission to impose conditions on this transaction that require Comcast-NBCU's retransmission consent agreements and its carriage agreements for online programming to both be subject to the nondiscrimination requirements and non-exclusivity requirements of program access rules. However, these conditions alone will clearly not be sufficient to fully remedy the vertical harms of this transaction.

3. BINDING ARBITRATION

In previous transactions with vertical harms, such as the DirecTV-News Corp. and Adelphia-Time Warner-Comcast transactions, one remedy used by the Commission has been to give parties that purchase certain classes of programming from the combined entity the right to ask for binding baseball-style arbitration with mandatory interim carriage in the event that a dispute over program fees cannot be resolved. The purpose of the arbitration is to determine a fair market value for the programming in question. In this report I will refer to this arbitration process as the "regular arbitration process" to distinguish it from another arbitration process which the ACA conditions would also implement which I will refer to as the "special arbitration process for smaller MVPDs." The important point that I wish to make in this section of my report is that the regular arbitration process has turned out to be unaffordable for smaller MVPDs. I believe that making the regular arbitration process available to MVPDs would be a very reasonable condition for the Commission to consider in order to help protect larger MVPDs and their customers from the competitive harms of this transaction. However, the fact that it is not affordable for smaller MVPDs means that additional conditions still need to be adopted to protect smaller MVPDs and their customers.

The essential economic issue is that the costs of engaging in an arbitration are relatively fixed regardless of the number of subscribers that an MVPD has. However, the potential benefits of engaging in an arbitration - lower programming fees - are of course directly proportional to the number of subscribers that an MVPD has. Therefore, incurring the cost of engaging in a full-blown arbitration proceeding becomes progressively less attractive to an MVPD as its subscribership decreases.

For purposes of designing an appropriate set of conditions, the Commission will have to determine of the level of MVPD subscribership below which this type of arbitration becomes unaffordable. The key parameter in such a calculation is of course the total cost of engaging in such an arbitration. In my initial report, I noted that Colleen Abdoulah, the CEO of the cable system operator WOW! has testified that, when her company was faced with the decision of whether to undertake such an arbitration, it determined that the likely cost would exceed $1 million and that this estimate did not include the cost of the time that WOW!'s own management and employees would need to devote to the arbitration.[42] Since I wrote my original report, a declaration by Robert Gessner, President of Massillon Cable TV, Inc. has been filed with the Commission in which he describes his actual experience when he attempted to use the arbitration process to settle a dispute with Fox Cable Networks, Inc. He reports that his actual arbitration costs were approximately $1 million and that this cost estimate does not include the cost of the time that Massillon's own management and employees devoted to this issue.[43] Based on this evidence, I conclude that $1 million dollars is a reasonable estimate of the cost of participating in such an arbitration and may actually be somewhat conservative in the sense that it does not include

[42] "The FCC sought to tighten these loopholes in subsequent transactions between content providers and distributors, for instance, by permitting complainants to use third-party arbitration or collectively bargain for rights. But, here again, programmers affiliated with larger cable operators quickly found how to beat the system. WOW! considered using the arbitration process imposed on Comcast in the Adelphia decision but determined the cost of the process was likely to exceed $1 million, take one year or longer, and require key personnel to take large amounts of time from their regular jobs. In other words, the costs of using arbitration were going to be close enough to the extra price Comcast was going to charge us in the first place. Instead, we had no choice but to "eat" an enormous rate increase to carry Comcast's RSN. In effect, the program access process has essentially given us a right without a remedy. It would be a grave error to buy into the contention of Comcast and NBC Universal that these processes constitute a legitimate backstop for anticompetitive harms arising from the deal." *See Testimony of Colleen Abdoulah, President and CEO, WOW! Board Member ACA Before the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights*, February 4, 2010 at page 8.

[43] "When all costs of arbitration are considered, Massillon spent approximately $1,000,000 from the date of the arbitration request (October 2006) through the present day. The amount does not include the considerable out-of-pocket costs (including travel expenses) incurred by Massillon and substantial time and resources spent by Massillon management and employees to participate in the dispute and arbitration process." *See Gessner Declaration* at para. 15.

the cost of the time that an MVPD's own management and employees would need to devote to the arbitration.

I will now suggest one possible approach that the Commission could use to determine the level of MVPD subscribership below which this type of arbitration becomes unaffordable. In particular, I will describe a set of payoffs that could be interpreted as describing a "reasonably strong" case for which the Commission would hope that arbitration would be a feasible alternative for an MVPD and calculate the level of subscribership for an MVPD at which the MVPD would view the expected benefits of the arbitration as being exactly equal to the costs. This would mean that an MVPD with any lower level of subscribership would be unwilling to engage in arbitration.

Suppose that Comcast-NBCU is raising the fee for a particular network above its fair market value by \$.50 per subscriber per month.[44] Suppose that an MVPD believes that it has a 50% chance of winning an arbitration case on this issue, which would result in a fee decrease of \$.50 per subscriber per month over the life of the contract. I will assume that the contract lasts 3 years (36 months) and that the MVPD uses a cost of capital of 10%. Straightforward calculation shows that the expected discounted gain to the MVPD from engaging in an arbitration is then equal to \$7.80 per subscriber.[45] If the MVPD has s subscribers then its expected net benefit to participating in the arbitration is given by

$$7.80\,s \quad - 1{,}000{,}000 \qquad \text{(IV.1)}$$

[44] Recall that this is the approximate amount that I predict retransmission consent fees will rise by due to the vertical aspect of the transaction in the six DMAs with an NBC O&O where Comcast has a substantial presence as a cable provider.

[45] The present discounted value of \$1 per month for 36 months using an annual interest rate of 10% is \$31.20. Therefore the present discounted value of the expected fee increase from arbitration is equal to ½ x \$.50 x 31.20 or \$7.80.

The first term of Equation (IV.1) is the expected benefit from winning the arbitration and the second term is the cost of the arbitration. Let s^* denote the level of subscribership at which the MVPD would just break even from participating in the arbitration. It is given by

$$s^* = 1{,}000{,}000/7.80 = 128{,}205. \qquad \text{(IV.2)}$$

Based on this calculation, it therefore appears that an MVPD with fewer than approximately 125,000 subscribers for any particular piece of programming would not find it affordable to enter into arbitration even when it had a reasonably strong case.

4. THE ACA CONDITIONS

In this section I will describe the conditions being suggested by the ACA and explain why they would substantially address the competitive harms of the transaction that I heve identified for both large MVPDs as well as smaller MVPDs.[46] The set of conditions that the ACA is proposing can be divided into five main groups. I will consider each group of conditions separately and explain the economic role that each group plays in remedying the harms of the transaction. The section numbers in parentheses in each sub-title below refer to the numbering used in the formal statement of the conditions.

[46] Recall that a complete statement of the ACA proposed conditions is contained in attachment C to the *ACA Reply Comments*.

Program Access Conditions (Section II.A)

This group of conditions simply extends the applicability of the non-discrimination and non-exclusion requirements of program access rules to apply to Comcast-NBCU's retransmission consent agreements and its carriage agreements for online programming. As discussed above, while these conditions will likely place some additional restraint on Comcast-NBCU's ability to disadvantage rival MVPDs, they will clearly not be sufficient to fully address the problem.

The Regular Arbitration Process (Section II.C)

This condition allows MPVDs purchasing programming from Comcast-NBCU to request baseball-style binding arbitration and is the type of condition that the Commission used to remedy vertical competitive harms in both the DirecTV-News Corp. and Adelphia-Time Warner-Comcast transactions. As I noted above, I will refer to this type of arbitrations process as the "regular arbitration process" to distinguish it from another type of arbitration process which the ACA conditions also implement (and which will be described below) which will I will call the "special arbitration process for smaller MVPDs."

An important point to note about the regular arbitration process in the context of the Comcast-NBCU transaction is that it can remedy both the vertical and horizontal competitive harms of the transaction. That is, to the extent that the arbitration process allows MVPDs to obtain programming from Comcast-NBCU at fair market value, it will prevent Comcast-NBCU from charging fees higher than fair market value regardless of whether the problem originates with the horizontal or vertical aspect of the transaction. The fact that the condition remedies both vertical and horizontal competitive harms is one of the rationales for applying it to all types of

Comcast-NBCU programming and not just to programming that was owned by NBCU prior to the transaction. In particular, it provides a rationale for applying the binding arbitration condition to Comcast RSNs.

Note that the ACA condition makes binding arbitration available for MVPDs purchasing any type of programming from Comcast-NBCU, including NBC O&Os, Comcast RSNs, and national cable networks. In past transactions the Commission has limited the availability of binding arbitration to carriage agreements for local broadcast stations and RSNs. I argued in my initial report that the block of popular NBCU national cable networks has ratings as high or higher than most of the Big 4 broadcast networks and that it is plausible that withdrawal of this block of programming might have as large an effect on an MVPDs subscribership as withdrawal of the signal of an NBC O&O or RSN.[47] To the extent that this is true, the rationale for making the binding arbitration remedy available to MVPDs that purchase carriage of NBC O&Os or RSNs applies equally well to MVPDs that purchase carriage of national cable networks.

As I explained above, the main problem with this type of condition is that smaller MVPDs have found this type of arbitration to be unaffordable. Thus, while it may remedy the harms of the transaction for larger MVPDs and their customers, it provides little relief for smaller MVPDs and their customers. The remaining conditions are largely focused on providing the same relief for smaller MVPDs that the regular arbitration process will provide for larger MVPDs.

Stand-Alone Agreements for NBC O&Os and Comcast RSNs (Section II.B)

This group of conditions requires that when Comcast-NBCU enters into carriage agreements for NBC O&Os or RSNs with any MVPD, that it sign a separate agreement for each

[47] *See Rogerson Report I* at pages 9-10.

NBC O&O and a separate agreement for each RSN.

The purpose of this group of conditions is to dramatically increase the transparency of Comcast-NBCUs pricing arrangements for its RSNs and NBC O&Os in order to reduce the cost of arbitration over the pricing of these types of programming. When multiple different types of programming are bundled together in a single carriage agreement, there is no simple way to determine the rate that each individual item of programming is being sold for. Thus the issue of determining the fair market value of any particular type of programming becomes much more difficult and complex. The fact that Comcast-NBCU will be required to use stand-alone agreements for carriage of each of its NBC O&Os and RSNs means that the it will be relatively straightforward for an arbitrator to determine the rates that Comcast charges other MVPDs for NBC O&Os and RSNs. Of course a complete determination of fair market value may still require consideration of the rates that other programmers charge for similar type of programming as well as factors such as the advertising revenue that the programming generates. Thus the determination of fair market value in the regular arbitration process may still be somewhat complex and costly. However, even a moderate reduction in the cost of the regular arbitration process would be of benefit. Furthermore, as will be described below, the increased transparency of Comcast-NBCUs pricing for carriage of NBC O&Os and RSNS will have an even more dramatic effect on reducing the costs of the new special arbitration process for smaller MVPDs.

Special Rules for Smaller MVPDs (Sections III.A and III.B)

This group of conditions requires that Comcast-NBCU make carriage of its NBC O&Os and RSNs available to smaller MVPDs at rates no more than 5% higher than the best rates that

Comcast-NBCU offers any MVPD. The purpose of this group of conditions is to provide smaller MVPDs with the same protection from programming fee increases for carriage of NBC O&Os and RSNs that larger MVPDs will receive from the regular arbitration process already described above. A special commercial arbitration process for smaller MVPDs is established that allows an MVPD to file a complaint if it believes this condition is not being met. If an MVPD files a complaint, Comcast-NBCU will be obliged to formally make the MVPD a final offer and to provide an arbitrator with both the final offer and with access to all of its contracts so that the arbitrator can make an independent interpretation of whether the rate in the final offer is no more than 5% higher than the best rate that Comcast-NBCU offers any MVPD for the programming in question. If the offer meets the condition, this becomes the carriage agreement. If it does not meet the condition, the arbitrator adjusts the rate appropriately so that the condition is met and then this adjusted offer becomes the carriage agreement.

The key point to notice is that, because of the conditions described above that require stand-alone contracting for NBC O&Os and RSNs, the arbitration process required to determine whether the 5% condition is being met will be extremely simple and therefore very inexpensive. In particular, it should be affordable my most smaller MVPDs. Since the stand-alone contracting condition already will result in a completely transparent price for each carriage agreement that Comcast-NBCU signs for NBC O&Os and RSNs, and the arbitrator will have access to all of these contracts, the only issue of any substance to deal with will be that the particular terms and conditions under which carriage of a given NBC O&O or RSN is provided may vary somewhat from MVPD to MVPD. However, it is a standard commercial practice in the programming industry, for purposes of enforcing MFN agreements, to calculate dollar equivalents for variations in terms and conditions. Such calculations produce a so-called "Net Effective Rate" for each contract that provides the effective rate corrected for differences in terms and conditions. The condition instructs the arbitrator to follow this standard commercial practice. Namely the arbitrator is instructed to deal with variations in terms and conditions by calculating the net effective rate of each agreement and then simply checking if the net effective rate being offered to the MVPD no more than 5% higher than the lowest net effective rate received by any MVPD for the programming in question.

Three additional points to note about this group of conditions are as follows.

First, the provision that rates for smaller MVPDs may be 5% higher than the best rates that Comcast-NBCU offers any MVPD is meant to allow for the fact that there may be some cost savings associated with contracting with larger MVPDs in the sense that the fixed cost of contracting can be spread over a larger number of subscribers. I believe that 5% is likely a very generous over-estimate of the extent to which programmers' per subscriber costs of dealing with smaller MVPDs are higher than their per subscriber costs of dealing with larger MVPDs. In the course of reviewing this transaction, the Commission may consider assessing for itself the magnitude of such cost differences and use this to determine the appropriate percentage.

Second, the rationale for defining "smaller MVPDs" as being MVPDs with 125,000 or less subscribers for the programming in question was developed in Section IV.3 above.

Third, note that the arbitration process is this case is not baseball-style arbitration where both parties make offers and the arbitrator selects the offer that most closely meets the condition specified in the arbitration rules. Instead, only Comcast-NBCU makes a final offer and then the arbitrator directly determines if this offer meets the 5% condition or not.[48] The rationale for using

[48]Under baseball-style arbitration, both Comcast-NBCU and the MVPD would make final offers

this simpler type of arbitration is that, since Comcast-NBCU and the arbitrator will both have access to all of Comcast's contracts and the MVPD will not, Comcast-NBCU and the arbitrator will both have vastly superior information about the value of the correct rate than will the MVPD. Furthermore under the specified arbitration process Comcast-NBCU will know that it has to choose a rate that meets the 5% condition because the arbitrator will find it very easy to determine if the condition is met. Therefore there will be no need (or advantage) to try to involve the MVPD in a more active way. That is, the arbitrator is the appropriate actor to discipline Comcast-NBCU because it will have access to the same information that Comcast-NBCU has access to and it will be simple and inexpensive for the arbitrator to directly determine if the 5% condition is met.

Special Rules for Bargaining Agents (Section III.C)

The previous group of conditions is designed to protect smaller MVPDs from programming fee increases for carriage of NBC O&O's and Comcast RSNs due to the transaction. This group of conditions is designed to provide smaller MVPDs with protection from programming fee increases for national cable networks due to the transaction. This turns out to be a simpler problem to address because of the fact that the National Cable Television Cooperative (NCTC) already acts as a bargaining agent on behalf of most smaller MVPDs and collectively represents all of them in negotiations over fees for national cable networks.

The manner in which the NCTC negotiates agreements on behalf of its members is as follows. The NCTC begins by negotiating the terms and conditions of a carriage agreement for a particular network or group of networks with a programmer. At the time the agreement is

---

and the arbitrator would choose the offer that is closest to being 5% higher than the best rate that Comcast-NBCU offers any MVPD for the programming in question.

negotiated, the NCTC has no authority to commit any of its members to accept the agreement. Rather, after the agreement is negotiated, members of the NCTC have the option to opt into the agreement if they wish. In the terms of the formal language of the ACA conditions, the NCTC is a bargaining agent whose members "are not bound by the prices, terms, and conditions entered into by the bargaining agent."[49]

It is generally the case in the programming industry that, holding all other factors constant, that an entity purchasing carriage rights for programming will be able to negotiate a lower per subscriber programming fee as the number of subscribers it is purchasing programming for increases. The main purpose of the NCTC is to attempt to obtain lower rates for its members by collectively negotiating on their behalf. Programmers and the NCTC deal with the fact that the NCTC is not able to commit its members in advance by negotiating different rates depending on the actual number of subscribers that end up receiving the programming under the agreement. Higher numbers of subscribers generally result in lower per subscriber rates. I will refer to a rate schedule that specifies the actual per subscriber rate that will be paid as a function of the total number of subscribers that actually end up being served under the agreement as a "conditional rate schedule."

This group of conditions takes two different approaches to strengthening the NCTC's ability to negotiate better programming fees on behalf of its members. The first approach, described by the conditions listed in Section III.C.1, is to more clearly require Comcast-NBCU to allow NCTC to negotiate contracts on behalf of all of its members, including its largest members. In particular, programmers sometimes inform the NCTC that some of its members will not be

[49] *See ACA's Proposed Comcast-NBCU License Transfer Conditions*, Appendix B of this report, Sections III.C. 1.b and III.C.2.a.

eligible to opt into particular agreements. Other programmers simply refuse to negotiate conditional rate schedules for large subscriber levels corresponding to the case where most NCTC members, including its largest members, opt into a deal. Finally, it may be that some programmers pressure particular MVPDs that are members of the NCTC to agree to separate carriage agreements that contain the provision that they are not able to opt into deals negotiated by the NCTC even if these deals contain better terms. The conditions in Section III.C.1 prohibit these types of behaviors. In a sense these are relatively weak conditions, since nothing would prevent a programmer subject to them from simply announcing a rate schedule that specifies the same high rate regardless of the total number of subscribers that end up being covered by agreement. Similarly, nothing would prevent larger NCTC members from accepting individual programming agreements that committed them not to opt into NCTC deals so long as they found these deals more attractive than deals that did not require this commitment. However, based on my discussions with NCTC staff and with other industry participants, there is a general belief that requiring Comcast-NBCU to agree to these "good faith" conditions might well result in NCTC being able to negotiate deals that more of its members would opt into and that result in all of them paying lower programming fees. I certainly see no harm in the Commission adopting this type of condition. At minimum, it might provide useful information on the efficacy of this type of "good faith" condition that could inform the Commission's decision-making in future transactions that it considers.

The second approach, described in Section III.C.2 of the conditions, provides a much more tangible mechanism that will increase the ability of the NCTC to achieve lower program rates more commensurate with the aggregate subscribership of its members. This approach gives

NCTC the same rights as any individual MVPD to request that the regular binding arbitration process be used to determine the fair market value for programming. Furthermore the binding arbitration process is used to determine an entire conditional rate schedule over the entire range of subscribership levels that the NCTCs membership could provide.[50] The condition instructs the arbitrator that the fair market value of the programming at any subscribership level is defined to be the fair market value of the programming for an MVPD with this number of subscribers.

By allowing smaller MVPDs to collectively engage in a single arbitration to determine a fee that they all pay, this approach completely finesses the problem that individual smaller MVPDs are not able to afford the arbitration process. Thus, through this approach, the regular arbitration process would essentially become available to smaller MVPDs for the case of national cable networks.

V. CONCLUSION

In my initial report (*Rogerson Report I*), I described and estimated the magnitude of two significant competitive harms that will result from this transaction. The Applicants for this transaction subsequently submitted an economic report by Drs. Mark Israel and Michael L. Katz (*Israel Katz Report II*) meant to refute the analysis in my initial report. In this follow-up report, I have presented my own analysis of *Israel Katz Report II*. In particular, I have explained why this report fails to successfully refute any of the arguments that I advanced in my initial report. [

[50] Specifically, it allows the MVPD to select a set of different subscribership levels, where each subscribership level can be any number less than or equal to the aggregate number of subscribers of its entire membership, and ask for binding arbitration to determine a rate for each subscribership level. Baseball-style arbitration is used to set the rate for each subscribership level. That is, both firms announce a rate for each subscribership level and the arbitrator chooses the rate closest to the fair market value of the programming for each subscribership level.